

Management's Discussion and Analysis

This analysis, prepared by the Office of the Comptroller, offers readers of the Commonwealth's financial statements a narrative overview of the activities of the Commonwealth for the fiscal year ended June 30, 2003 (FY03). We encourage readers to consider this information in conjunction with the additional information that is furnished in the letter of transmittal, which can be found preceding this narrative, and with the Commonwealth's financial statements, which follow. This analysis is required by the Governmental Accounting Standards Board (GASB) which provides preparers with guidelines on what must be included and excluded from this analysis. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

Financial Highlights – Primary Commonwealth Government

Government – Wide Highlights

- ◆ **Net Assets** – The liabilities of the Commonwealth exceeded its assets at the end of FY03 by nearly \$5.8 billion. Of this amount, “unrestricted net assets” is reported as a negative \$9.0 billion. The primary reason for this is that the Commonwealth is incurring long term obligations to either construct or assist political subdivisions in constructing assets owned by these political subdivisions. For example, upon completion the Central Artery / Third Harbor Tunnel will be owned by the Massachusetts Turnpike Authority and the Massachusetts Port Authority. The Commonwealth, however, is paying for the construction of these assets and significant debt is being incurred to pay those costs. The Commonwealth's liability for school building assistance payments for municipal school construction also is a \$4.1 billion contributor to negative unrestricted net assets. There are also significant restricted net asset balances set aside for unemployment benefits and debt retirement.
- ◆ **Changes in Net Assets** – The Commonwealth's net assets decreased by over \$1.8 billion in FY03. Net assets of governmental activities decreased by over \$1.1 billion. This decrease in net assets is primarily attributable to an overall decrease in current cash, receivables and investments of \$115 million, coupled with an increase in current liabilities for \$216 million and an increase in long-term debt for \$1 billion. For the fiscal year, the Commonwealth's tax revenues increased \$473 million above prior year collections. Net assets of the business – type activities showed a decrease of nearly \$719 million. Expenses of governmental activities were over \$30.8 billion. General revenue, net of transfers, but including taxes, investment income and tobacco settlement income from governmental activities was nearly \$16.3 billion.
- ◆ **Governmental Funds – Fund Balances** – As of the close of FY03, the Commonwealth's governmental funds reported a combined ending fund balance of over \$2.0 billion. Of the \$2.0 billion:

Fund Highlights

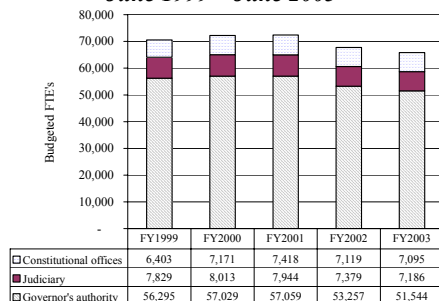
- \$145 million, net deficit, represents the unreserved fund balance. This is largely due to a \$582 million deficit in the highway fund and a \$14 million deficit in the lotteries fund due to the timing of accruals. The unreserved general fund balance of over \$619 million offsets these deficits.
- During FY03 the Legislature adopted a more straightforward definition of fiscal balance to include all of the budgeted activity. The result was the elimination of a number of funds, including the local aid fund. The previous definition of fiscal balance only included the fund balance within three major funds. As a result of these changes, several minor Governmental Funds have also been closed.
- Governmental reserves total nearly \$2.2 billion. They include \$51 million for continuing appropriations, \$641 million for stabilization, \$936 million in bond proceeds reserved for capital projects, largely connected with the Central Artery / Tunnel (CA/T) project and \$337 million reserved for retirement of indebtedness. An additional \$200 million is reserved for the CA/T owner controlled insurance program for workers' compensation and general liability. This reserve is net of \$76 million of projected long-term claims payable that are only reflected on the statement of net assets.

To meet the fiscal challenges of fiscal 2003 and beyond, the Commonwealth took a series of measures to remain in fiscal balance.

- \$550 million was removed from the Stabilization Fund on July 1. However, at the close of the fiscal year, \$227 million was redeposited into the fund from proceeds that resulted from tax loophole closure and residual balances deposited from the fund closures discussed above. An additional \$75 million was transferred to the fund from surplus. Beginning in FY05, an additional 0.5% of current year net tax revenues must be deposited into the Stabilization Fund before the year – end surplus is determined in addition to the current statutorily required carry-forward amount. Finally, the ceiling on the balance in the Stabilization Fund was increased from 10% to 15% of total current year budgeted revenues.
- All of the tobacco settlement proceeds for the year were used in support of current operations, up from 50% in the prior year.
- \$39 million was removed from surplus funds set aside for capital projects in previous years, also to support current operations.
- The Commonwealth refunded over \$3 billion in general obligation bonds, taking advantage of some of the lowest interest rates in history. The Commonwealth refrained from issuing tobacco settlement bonds or pension obligation bonds, which many of our peer states have either considered or sold.

- Approximately \$213.2 million of Medicaid related spending has been moved to a fund not controlled by the appropriation process, but subject to revenues, funded by fees and related federal financial participation.
- There was a \$878 million net decrease from the Unemployment Compensation Fund, reducing the ending balance in this fund to approximately \$627 million. The Department of Employment and Training estimates that the fund will be operating at a deficit by January 2004. State law provides that in the event of a deficit in this Fund that is not paid back by September 2004, additional revenues will be collected from employers in order to pay the interest that has accrued on the debt.
- In FY04, the pension obligation has been removed from the budget process using transfers of surplus and the transfer of the value of the Hynes Convention Center and the Boston Common Garage from the Massachusetts Convention Center Authority to the Pension Reserves Investment Trust.

**Budgeted Full Time Equivalent
Workforce
Including Budgeted Higher Education
June 1999 – June 2003**



The Commonwealth also took measures operationally to achieve balance.

- The budgeted full time equivalent workforce, including budgeted higher education equivalent count dropped from 67,755 as of June 2002 to 65,825 as of June 2003. The graphic to the left details the reductions over the last five years. The FY04 General Appropriation Act included another employee retirement incentive reduction plan, which is expected to further reduce the Commonwealth's workforce.
- Starting in FY04, the employee's share of group health insurance premiums will increase from 15% to 20% of the cost of the insurance for those who earn more than \$35,000. All new employees hired after June 30, 2003 will contribute 25% of the cost of the insurance, regardless of salary.
- Tax decreases enacted earlier than FY02 were frozen. The income and the capital gains tax rate remains at 5.3%. Charitable deductions were eliminated and cigarette tax rates have doubled to \$1.51 per pack.

OVERVIEW OF THE FINANCIAL STATEMENTS

Government – wide Financial Statements and how they relate to other perspectives

This discussion and analysis is intended to serve as an introduction to the Commonwealth's basic financial statements. The Commonwealth's basic financial statements are composed of three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to the financial statements. This report also contains additional required supplementary information in the form of budgetary schedules, which are prepared on the statutory basis of accounting, as well as other supplementary information.

The government - wide financial statements present the reader with a broad overview of the Commonwealth's finances in a manner similar to a private sector business. The statements include the *Statement of Net*

Assets, which present the assets, liabilities and net assets for the government as a whole. Also presented is the *Statement of Activities*, which presents the functional expenses, offsetting revenues and changes in net assets of the Commonwealth. Both of the statements have separate sections for three different categories of the Commonwealth's operations. These activities are *Governmental Activities*, *Business-Type Activities* and *Discretely Presented Component Units*.

The government – wide financial statements can be found immediately following this discussion and analysis.

Fund Financial Statements and Component Unit Financial Statements

Funds are groups of related accounts that are used to maintain control over resources that have been segregated for specific activities or objectives. The Commonwealth, like other governments, uses fund accounting to ensure and demonstrate compliance with finance related legal requirements. Their financial statements focus on individual parts of the Commonwealth government, reporting its operations in more detail than the government – wide statements. All of the funds of the Commonwealth can be divided into three categories. It is important to realize that these fund categories use different bases of accounting and should be interpreted differently. The three categories of funds are *Governmental Funds*, *Proprietary Funds* and *Fiduciary Funds*. Further discussion on the funds can be found in the section “Financial Analysis of the Commonwealth’s Funds” and in Note 1 to the financial statements.

Component unit financial statements are presented for entities where the Commonwealth has financial accountability, but are independent of the core Commonwealth operations. They operate similar to private - sector businesses.

Notes to the Financial Statements, Required Supplementary Information and Other Supplementary Information

The notes provide additional information that is essential to a full understanding of the financial statements as of the date provided in the government – wide and the fund financial statements. The notes to the financial statements can be found immediately following the component units’ financial statements.

The required supplementary information section includes budgetary comparison schedules for the General, Highway and Local Aid Funds, along with a reconciliation comparing the original general appropriation act, all supplemental appropriations and actual budgetary spending. Variance columns are also provided. GASB Statement 41 - *Budgetary Comparison Schedule Perspective Differences*, which is effective for FY03, requires a further reconciliation schedule of the budgeted revenues and expenses to governmental fund perspective revenues and expenditures.

Other supplementary information is not mandatory, but is included to present combining schedules of minor governmental funds.

GOVERNMENT – WIDE FINANCIAL ANALYSIS

Net Assets

Net assets may serve over time as a useful indicator of a government’s financial position. The Commonwealth’s combined net assets (governmental and business-type activities) showed a net deficit of over \$5.7 billion at the end of 2003. The *unrestricted net assets* are negative by nearly \$9.0 billion. A substantial portion of this deficit is a result of four programs where the Commonwealth decided to fund assets that

**Major Long – Term Obligations for
Assets of Political Subdivisions
(amounts in millions)**

Municipal school construction grants	\$ 4,074
Other long - term assistance to Authorities	697
Bonds issued to fund the MBTA	910
Central Artery / Tunnel Project to be transferred to the Turnpike.....	10,285
Central Artery / Tunnel Project to be transferred to Massport.....	365
Change in Unrestricted Net Assets due to Items Unique to the Commonwealth.....	<u>\$ 16,331</u>

it does not own. The most significant example of this is to the aforementioned Commonwealth bonding for the Central Artery / Tunnel Project (CA/T) costs. Pursuant to the Metropolitan Highway System legislation from 1997, the CA/T will transfer to the Massachusetts Turnpike Authority and to the Massachusetts Port Authority (Massport) upon completion. Portions that have not been transferred are shown as payables on the Statement of Net Assets. While the assets will be with the Turnpike Authority and Massport, a large portion of the liabilities will remain with the Commonwealth. Only slightly over \$2 billion of these transfers have taken place. As part of the budget submission for FY04, the Governor introduced legislation to consolidate the Turnpike Authority's operations with the Commonwealth, effectively eliminating this large payable and other obligations. However, the legislation did not pass. Another example of this type of arrangement is school building assistance. The Commonwealth funds a large portion of costs incurred by cities and towns to construct or rehabilitate their schools. These obligations are part of the school construction grants program. In total, these types of liabilities amount to approximately \$16.3 billion at June 30, 2003.

Exclusive of assets where the Commonwealth acts as a fiduciary, the Commonwealth's current cash and investments decreased by over \$467 million between July 1, 2002 and June 30, 2003. This is directly due to the large outflows of cash for unemployment compensation and for capital projects, along with continuing costs associated with the Commonwealth's core expenses for debt service, Medicaid and in FY03, public safety. The year was also marked by a significant amount of commercial paper borrowing due to these fiscal conditions in order to finance events such as the payment of local aid.

Net of CA/T spending and transfers of \$984 million, long – term assets decreased by about \$109 million. A total of nearly \$22.5 billion of the Commonwealth's net assets reflect the Commonwealth's investment in traditional capital assets such as land, buildings, infrastructure and equipment, net of accumulated depreciation. GASB Statement 34 requires the addition of the value of investment in the Commonwealth's infrastructure, including roads, bridges, beaches, dams and other immovable assets to the face of the Commonwealth's financial statements. As these assets provide services to citizens, they are not available to finance future spending unless they are sold. Although the Commonwealth's investment in its capital assets is also reported net of related debt, it must be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

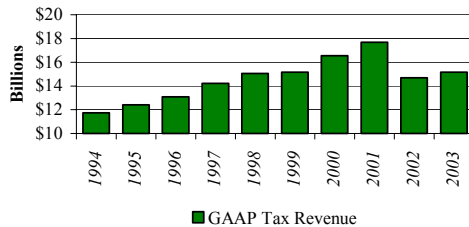
The bulk of the Commonwealth's net assets lie in its capital assets and long – term liabilities. Current assets and liabilities are amounts that are available in the current period and obligations that will be paid within one year, respectively. The Commonwealth's current assets were over \$7.6 billion, while its current liabilities were nearly \$6.8 billion. Restricted net assets represent resources that are subject to external constraints on resources. The tables below portray the Commonwealth's net assets and the changes to those net assets for the fiscal year. Note that certain amounts were reclassified from FY02 to conform to the FY03 presentation.

Net Assets as of June 30, 2003 and 2002
(in millions of dollars)

	<u>Governmental Activities</u>		<u>Business - Type Activities</u>		<u>Total Primary Government</u>	
	<u>June 30, 2003</u>	<u>June 30, 2002</u>	<u>June 30, 2003</u>	<u>June 30, 2002</u>	<u>June 30, 2003</u>	<u>June 30, 2002</u>
Current and other non-capital assets.....	\$ 7,264	\$ 7,424	\$ 2,179	\$ 3,012	\$ 9,443	\$ 10,436
Capital assets.....	<u>20,883</u>	<u>19,666</u>	<u>1,590</u>	<u>1,486</u>	<u>22,473</u>	<u>21,152</u>
Total Assets.....	<u>28,147</u>	<u>27,090</u>	<u>3,769</u>	<u>4,498</u>	<u>31,916</u>	<u>31,588</u>
Long term liabilities.....	30,031	28,084	861	853	30,892	28,937
Other Liabilities.....	<u>6,221</u>	<u>5,982</u>	<u>566</u>	<u>585</u>	<u>6,787</u>	<u>6,567</u>
Total Liabilities.....	<u>36,252</u>	<u>34,066</u>	<u>1,427</u>	<u>1,438</u>	<u>37,679</u>	<u>35,504</u>
Net assets:						
Invested in capital assets, net of related debt.....	76	(105)	1,073	1,032	1,149	927
Restricted.....	1,154	2,694	946	1,784	2,100	4,478
Unrestricted.....	<u>(9,335)</u>	<u>(9,566)</u>	<u>322</u>	<u>244</u>	<u>(9,013)</u>	<u>(9,322)</u>
Total Net Assets (deficits)	<u><u>\$ (8,105)</u></u>	<u><u>\$ (6,977)</u></u>	<u><u>\$ 2,341</u></u>	<u><u>\$ 3,060</u></u>	<u><u>\$ (5,764)</u></u>	<u><u>\$ (3,917)</u></u>

Changes in Net Assets

Revenue from Taxation – GAAP Basis 1994-2003



The Commonwealth's net assets decreased by over \$1.8 billion. This drop is largely due to increased spending in the Unemployment Compensation Fund, and Higher Education, along with increases to Medicaid and other Health and Human Services largely connected to skyrocketing medical costs. Other programmatic expenses remained largely unchanged. The only major exception was for primary and secondary education, which dropped significantly due to a freeze on new school building construction assistance. Revenues increased, led by tax revenue increases of \$473 million and operating grants and contributions increases of \$432 million. Charges for services also increased by \$394 million. Approximately 45% of the Commonwealth's total revenue came from taxes, while the remainder resulted from programmatic revenues, including charges for services and grants and contributions, the bulk of which is federal aid.

The Commonwealth's revenues are presented in the table and graphics that follow. Note that certain amounts were reclassified from FY02 to conform to the FY03 presentation.

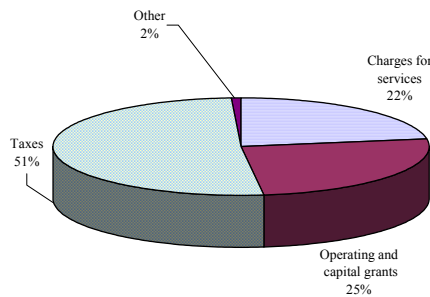
Changes in Net Assets during the Fiscal Years Ended June 30, 2003 and 2002 (in millions of dollars except percentages)

	Governmental Activities		Business - Type Activities		Total Primary Government		Total Primary Government		
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002	June 30, 2003 Percentage	June 30, 2002 Percentage	% Change
Revenues									
Program Revenues:									
Charges for services.....	\$ 6,652	\$ 6,474	\$ 1,943	\$ 1,727	\$ 8,595	\$ 8,201	25%	26%	0%
Operating grants and contributions.....	7,130	7,078	1,250	870	8,380	7,948	25%	25%	0%
Capital grants and contributions.....	508	-	-	77	508	77	1%	0%	1%
General Revenues:									
Taxes.....	15,162	14,689	-	-	15,162	14,689	45%	46%	-1%
Other.....	1,180	905	207	115	1,387	1,020	4%	3%	1%
Total Revenues.....	30,632	29,146	3,400	2,789	34,032	31,935	100%	100%	0%
Expenses									
Medicaid.....	6,177	5,979	-	-	6,177	5,979	17%	17%	0%
Direct local aid.....	5,119	5,253	-	-	5,119	5,253	14%	15%	0%
Other health and human services.....	4,314	4,196	-	-	4,314	4,196	12%	12%	0%
Lottery.....	3,470	3,454	-	-	3,470	3,454	10%	10%	0%
Higher education.....	-	-	2,480	2,365	2,480	2,365	7%	7%	0%
Primary and secondary education.....	1,385	1,836	-	-	1,385	1,836	4%	5%	-1%
Unemployment compensation.....	-	-	2,589	2,183	2,589	2,183	7%	6%	1%
Other.....	10,345	10,414	-	-	10,345	10,414	29%	29%	0%
Total Expenses.....	30,811	31,132	5,069	4,548	35,880	35,680	100%	100%	0%
Deficiency before transfers.....	(179)	(1,986)	(1,669)	(1,759)	(1,848)	(3,745)			
Transfers.....	(950)	(1,019)	950	1,019	-	-			
Decrease in Net assets (deficits).....	(1,129)	(3,005)	(719)	(740)	(1,848)	(3,745)			
Net assets - beginning.....	(6,976)	(3,971)	3,060	3,800	(3,916)	(171)			
Net assets - ending.....	\$ (8,105)	\$ (6,976)	\$ 2,341	\$ 3,060	\$ (5,764)	\$ (3,916)			

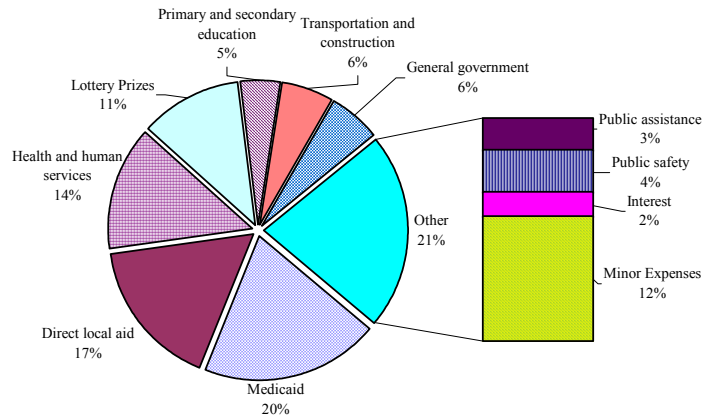
The largest category of tax revenue is income taxes. Of the \$15.2 billion in tax revenue within governmental activities, \$8.0 billion was from income taxation, \$3.8 billion from sales, \$929 million from corporations, \$678 million from motor fuels and nearly \$1.8 billion from other forms of taxation. The largest operating grants are the federal Medicaid subsidies. The largest capital grants are for transportation, including federal grants for the Central Artery / Tunnel project. Finally, Lottery revenues encompass approximately 51% of the Commonwealth's charges for services.

Medicaid represents 20% of all the Commonwealth's governmental expenses. However, it must be noted that over half of the Medicaid expenses are subsidized in the form of federal grants. These subsidies are noted below in the "charges for services" segment. The largest expense that is not subsidized by program revenues is direct local aid to the municipalities of the Commonwealth. According to the Department of Revenue, Division of Local Services, nearly 70% of these funds are earmarked for public education or related activities. Below is a chart that summarizes governmental expenses of the Commonwealth.

Revenue – Governmental Activities
Fiscal Year Ending June 30, 2003

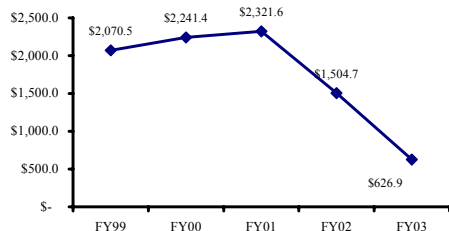


Major Expenses – Governmental Activities
Fiscal Year Ending June 30, 2003



Business – Type Activities

Unemployment Compensation Fund
Net Assets
Fiscal Year Ending June 30, 2003
(Amounts in Millions)



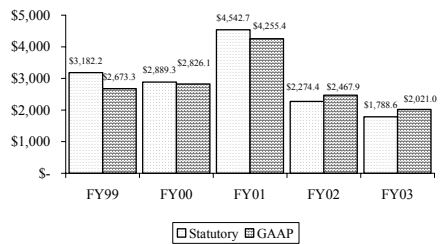
Business – type activities are functions that equate to activities of a private enterprise. In the Commonwealth the institutions of higher education are deemed to be business type activities because of their lack of separate taxation. Also, unemployment compensation is considered to be a business – type activity.

The business - type activities decreased the Commonwealth's net assets by nearly \$719 million. This primarily resulted from an \$878 million decrease in the Commonwealth's Unemployment Compensation Fund due to extended benefits for unemployed workers during the year. This decline was offset by a \$159 million increase in the net assets of the schools of higher education, largely due to increases in net tuition and fee revenue (by nearly 13%) and in federal grants and reimbursements (by nearly 44%).

FINANCIAL ANALYSIS OF THE COMMONWEALTH'S FUNDS

Governmental Funds

**Governmental Fund Balance
Statutory vs. GAAP**
(Amounts in Millions)



As noted earlier, the Commonwealth uses fund accounting to demonstrate interperiod equity and the extent to which current resources are financing the full cost of services that citizens are receiving.

Governmental funds account for the near term inflows, outflows and balances of spendable resources of the Commonwealth's core functions and services. Each major fund is presented in a separate column in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures and changes in fund balances. The basic governmental funds financial statements can be found immediately following the government-wide financial statements.

The Commonwealth develops its budgets on a statutory basis. A comprehensive process is conducted with all departments to convert the statutory basis reporting to generally accepted accounting principles. System generated reports from the state accounting system and data warehouses are combined with reports from each of the Commonwealth departments to record governmental fund perspective, departmental accruals. There are four major items which account for almost all the difference between the statutory basis reporting and the governmental fund perspective: accruals for the Medicaid program, compensated absences, claims and judgments and tax revenue accruals. From the governmental fund perspective, additional major adjustments are necessary to present the government wide statements, largely for debt and fixed assets activity.

Governmental Fund Operations - GAAP Basis - Fund Perspective (Amounts in millions)

	FY99	FY00	FY01	FY02	FY03
Beginning fund balances	\$1,863.1	\$2,673.3	\$2,826.1	\$4,255.4	\$2,467.9
Restatement due to implementation of GASB 34	-	-	-	551.2	-
Revenues and other financing sources.....	33,272.7	38,174.4	39,256.4	36,476.6	42,798.0
Expenditures and other financing sources.....	32,462.5	38,021.6	37,827.1	38,815.3	43,244.9
Excess / (deficiency).....	810.2	152.8	1,429.3	(1,787.5)	(446.9)
Ending fund balances	<u>\$2,673.3</u>	<u>\$2,826.1</u>	<u>\$4,255.4</u>	<u>\$2,467.9</u>	<u>\$2,021.0</u>

As of the end of fiscal 2003, the Commonwealth's governmental funds reported combined ending fund balances of \$2.0 billion, a decrease of \$447 million from the previous year. However, of the \$2.0 billion, the following amounts are reserved or committed:

Governmental Funds - Reserves of Fund Balances

(Amounts in millions)

	<u>2003</u>	<u>2002</u>	<u>Change</u>	<u>Percentage Change</u>
Continuing appropriations	\$ 50.7	\$ 168.0	\$ (117.3)	-70%
Commonwealth stabilization	641.3	881.8	(240.5)	-27%
Retirement of indebtedness	337.3	350.8	(13.5)	-4%
Capital projects	936.2	1,053.8	(117.6)	-11%
Central artery				
Workers Compensation and				
General liability insurance reserve..	200.2	239.9	(39.7)	-17%
Unreserved	(144.7)	(226.4)	81.7	-36%
Total Fund Balances	\$ 2,021.0	\$ 2,467.9	\$ (446.9)	

During FY03 over \$550 million was used from the stabilization fund to balance the budget. These draws were offset by contributions to the stabilization fund in the amount of nearly \$310 million.

The amounts reserved for capital projects represent projects that are in process, but have been bonded for in advance. As project costs are expended, the reserve will decrease. The bulk of these funds relate to the Central Artery / Tunnel project. The reserve for Central Artery workers' compensation and general liability represents the balance of funds earmarked for claims in an owner controlled insurance program. The reserve will continue to decline as claims arise during the windup of the project. The remaining \$145 million of the governmental fund balance is an unreserved and undesignated deficit.

During FY03 the general, highway and local aid funds were the primary operating funds of the Commonwealth. At the end of the current fiscal year, the fund balance of the general fund was over \$1.3 billion. Of this amount, over \$641 million was set aside in the Commonwealth's Stabilization Fund. Another \$49 million was also reserved for continuing appropriations to liquidate contracts and purchase orders from the prior fiscal year in the general fund. The remaining \$619 million is unreserved.

As of June 30, 2003, the Legislature closed 54 governmental funds and consolidated their respective fund balances and deficits to the Stabilization Fund. The local aid fund deficit was closed to the general fund. In addition, the Teacher, Principal, Superintendent Quality Endowment Fund was reclassified during FY03 as an "other governmental fund" as the Legislature adopted provisions to spend principal. This fund will close during FY04.

The fund balance of the general fund dropped by over \$1.0 billion during FY03. This is largely due to the closure of the local aid fund deficit into the General Fund.

Proprietary Funds

Proprietary Funds report activities of the Commonwealth that are structured similar to for profit businesses. Proprietary fund financial statements provide the same type of information as the government – wide financial statements, only in greater detail.

As discussed in the business – type activities above, the business type activities decreased the Commonwealth’s net assets by over \$720 million.

BUDGETARY HIGHLIGHTS

Differences between the original budget and final budget expenditures amount to over \$101 million, exclusive of transfers. Due to very low expectations of surpluses, supplemental budgets passed by the Legislation were very small. The supplemental budgets are summarized as follows:

- ◆ Increases in settlements and judgments by \$8.5 million.
- ◆ Increases in payments for snow plow operators and highway repairs for \$62.4 million.
- ◆ Increases for various courts, district attorneys, banking, regional transit authority assistance and supplemental school aid to local governments for \$25.1 million.

The original budget was passed in July of 2002, just after the start of FY03. Transfers of revenues and expenditures, largely from the closure of the local aid fund to the general fund resulted in nearly \$1.1 billion of additional financial uses, net.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

Capital assets of the Commonwealth include land, buildings, improvements, equipment, vehicles and infrastructure. The Commonwealth’s investment in capital assets for its governmental and business-type activities as of June 30, 2003, amounts to \$30.8 billion, net of accumulated depreciation of \$8.3 billion, leaving a net book value of \$22.5 billion. Infrastructure includes assets that are normally immovable and of value only to the Commonwealth, such as roads, bridges, beaches, piers and dams. Of the investment in capital assets noted above though, \$10.7 billion of this amount includes assets that will transfer to the Turnpike Authority and the Massachusetts Port Authority upon completion of the Central Artery / Tunnel project. An additional \$2.1 billion has already been transferred to these Authorities of completed portions of the project.

The total increase in the Commonwealth’s investment in capital assets from 2002 to 2003 was nearly \$1.7 billion, including increases to construction of the CA/T, but net of disposals and changes in accumulated depreciation. An additional \$211 million, net, was transferred from construction in process to fixed assets. Additional information on the Commonwealth’s capital assets can be found in the notes to the financial statements.

The following table details the capital asset activity for the Commonwealth:

Changes in Capital Assets
(net of depreciation - amounts in thousands)

	Governmental Activities		Business - type Activities		Total	
	2003	2002	2003	2002	2003	2002
Land	\$ 674,362	\$ 643,917	\$ 58,478	\$ 68,185	\$ 732,840	\$ 712,102
Historical treasures	-	-	672	553	672	553
Construction in process	729,867	465,797	154,698	115,740	884,565	581,537
Construction in process - Central Artery / Tunnel Project	10,650,559	9,666,140	-	-	10,650,559	9,666,140
Buildings	1,888,286	1,787,727	1,000,699	922,153	2,888,985	2,709,880
Machinery and equipment	123,415	124,919	269,359	265,030	392,774	389,949
Infrastructure	6,816,307	6,977,621	-	-	6,816,307	6,977,621
Library collections	-	-	106,540	114,679	106,540	114,679
Total	\$ 20,882,796	\$ 19,666,121	\$ 1,590,446	\$ 1,486,340	\$ 22,473,242	\$ 21,152,461

Debt Administration

The Commonwealth issues short-term and long-term debt. Debt that is general obligation in nature is backed by the full faith and credit of the Commonwealth and paid from governmental funds. Additionally, short-term notes are issued and redeemed annually.

The Commonwealth issued nearly \$5.0 billion in debt this year. Of this amount, \$1.9 billion to fund ongoing projects and over \$3.1 billion was in the form of general obligation refunding bonds, taking advantage of low interest rates. These refundings generated approximately \$127.8 million in present value debt service savings. Subsequent to year-end, the Commonwealth completed two additional refunding transactions which generated an additional \$47.6 million in present value debt service savings.

For governmental purposes, the \$1.9 billion in ongoing projects included debt issuances of:

- ◆ \$432.0 million for continuing costs of the Central Artery / Tunnel Project.
- ◆ \$284.5 million to bond for the final costs of the Massachusetts Bay Transportation Authority's "forward funding" mechanism.
- ◆ \$1.2 billion of other projects including \$133.8 million for environmental costs, \$111.7 million for affordable housing, \$76.1 million for information technology and \$37.2 million for public safety.

Nearly \$738 million in bond principal was repaid.

Additional information on the Commonwealth's short and long-term debt obligations can be found in the notes to the financial statements.

Below is a table, which details the Commonwealth's debt activity for the fiscal year:

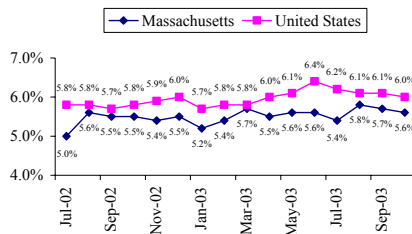
Changes in Long - Term Debt Obligations
(net of related premiums and discounts - amounts in thousands)

	<u>Governmental</u> <u>Activities</u>		<u>Business - type</u> <u>Activities</u>		<u>Total</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
General obligation bonds	\$ 13,724,120	\$ 12,691,884	\$ -	\$ -	\$ 13,724,120	\$ 12,691,884
Special obligation bonds	739,061	763,926	-	-	739,061	763,926
Revenue obligation bonds	-	-	673,398	670,430	673,398	670,430
Grant anticipation notes	1,499,325	1,499,325	-	-	1,499,325	1,499,325
Total	\$ 15,962,506	\$ 14,955,135	\$ 673,398	\$ 670,430	\$ 16,635,904	\$ 15,625,565

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

Massachusetts and the rest of the nation are in the midst of a profound economic downturn. Even though our Commonwealth is home to many world-renowned institutions of medicine and higher education, both public and private, keeping the economy relatively stable and full of ingenuity, no sector is immune from this current recession. However, the economy shows signs of improvement

**Monthly Unemployment Rate
July 2002 – October 2003**



The Commonwealth with an international reputation for medical, cultural, historical and educational institutions remains the economic and educational hub of New England. The Commonwealth's economy remains diversified, but its strongest component is its knowledge – based technology and service industries.

Massachusetts' infrastructure provides strong support for this knowledge-based economy. There are over 120 colleges and universities located in Massachusetts, and the 2000 US Census, updated in March of 2002, estimated that 34.3% of the residents over age 25 have earned bachelor's degrees, compared to an estimate of 26.7% for the United States as a whole. Massachusetts ranks third in the nation in educational attainment by age 25 within only 1.5% of the leader, Colorado.

Inflation has risen though in the past year. The Boston consumer price index rose 3.7% from July 2002 to July 2003. The largest component of this increase was due to fuel and utilities costs rising 17.6% during the period.

As of October 2003, the unemployment rate in the Commonwealth stood at 5.6%. This figure is down from a high of 5.8% in August, the highest rate since October of 1994. The Commonwealth is still below the national rate of 6.0%.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Commonwealth's finances for all of the Commonwealth's citizens, taxpayers, customers, investors and creditors. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Commonwealth of Massachusetts, Office of the State Comptroller, 1 Ashburton Place, 9th Floor, Boston, Massachusetts, 02108. You may also download this report at: <http://www.mass.gov/osc/reports/reports.htm>.